

Internal Revenue Service

Number: **200711005**

Release Date: 3/16/2007

Index Number: 2056.07-01, 2642.00-00,
2652.01-02, 9100.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-126967-06

Date:
November 17, 2006

Decedent	=
Date 1	=
Spouse	=
Children	=
Bypass Trust	=

Amount 1	=
Marital Trust	=

Amount 2	=
Accountant	=

Dear :

This responds to your representative's letter dated May 1, 2006, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever a trust into an exempt and nonexempt trust for purposes of generation-skipping transfer (GST) tax and to make a "reverse" qualified terminable interest property (QTIP) election under § 2652(a)(3) of the Internal Revenue Code with respect to the exempt trust.

FACTS

The facts and representations submitted are summarized as follows. Decedent died on Date 1, survived by Spouse and Children. Pursuant to the terms of Decedent's

revocable inter vivos trust, upon his death a Bypass Trust was funded with Amount 1 and a Marital Trust was funded with Amount 2.

Pursuant to the terms of the revocable inter vivos trust, the trustee may elect under § 2056(b)(7) to treat all or a part of the trust as QTIP property and, for Chapter 13 purposes, may elect under § 2652(a)(3) to treat all of the property for which a QTIP election was made as if the election to be treated as QTIP had not been made (a “reverse” QTIP election). Further, the trustee may administer that part of the Marital Trust that is subject to the “reverse” QTIP election and to which GST exemption has been allocated as a separate trust.

Spouse, the executor of Decedent’s estate, retained the services of Accountant, a CPA, to prepare Decedent’s Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. Accountant prepared Schedule M of Decedent’s Form 706, electing on behalf of the estate to treat the Marital Trust as QTIP under § 2056(b)(7). Accountant prepared Schedule M to further elect, for purposes of Chapter 13, to treat a portion of the Marital Trust as if the QTIP election had not been made. Accountant failed to make a “reverse” QTIP election under § 2652(a)(3). Accountant did not prepare Schedule R to allocate Decedent’s available GST exemption, even though all of Decedent’s GST exemption was available for allocation at his death.

In light of the foregoing, Decedent’s estate now proposes to divide the Marital Trust into the GST Exempt Marital Trust and the GST Nonexempt Marital Trust. The GST Exempt Marital Trust will be funded with a fractional share of Decedent’s estate passing to the Marital Trust, the numerator of which is equal to the Decedent’s remaining GST exemption after taking into account the automatic allocation of GST exemption to the Bypass Trust under § 2632, and the denominator of which is equal to the amount passing to the Marital Trust. The GST Nonexempt Marital Trust will be funded with the balance of the property passing to the Marital Trust. The GST Exempt Marital Trust and the GST Nonexempt Marital Trust will be funded on a non-pro rata basis, based on either the fair market value of the asset on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the Decedent’s date of death to the date of funding. A “reverse” QTIP election will then be made with respect to the assets of the GST Exempt Marital Trust.

You have requested the following rulings:

1. Decedent’s estate is granted an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever the Marital Trust into the GST Exempt Marital Trust and the GST Nonexempt Marital Trust pursuant to § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, and to make a reverse QTIP election under § 2652(a)(3) of the Internal Revenue Code for the GST Exempt Marital Trust.

2. The automatic allocation rules of § 2632(c) will operate to cause the unused portion of Decedent's GST exemption to be allocated to the GST Exempt Marital Trust.

Law & Analysis

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, the entire property shall be treated as passing to the surviving spouse for purposes of § 2056(a), and no part of such property shall be treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) defines the term "qualified terminable interest property" as property: (I) which passes from the decedent; (II) in which the surviving spouse has a qualifying income interest for life; and (III) to which an election under § 2056(b)(7) applies.

Section 2056(b)(7)(B)(v) provides that an election under § 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by § 2001, and that such an election, once made, shall be irrevocable.

Section 2601 imposes a tax on every GST. Section 2611(a) provides that the term "generation-skipping transfer" means: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate.

Section 2641(a) defines the term "applicable rate" with respect to any GST as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a)(1) provides that, generally, the inclusion ratio with respect to any property transferred in a GST is the excess of 1 over the "applicable fraction." With respect to a GST that is not a direct skip, § 2642(a)(2) provides that, in general, the applicable fraction is a fraction the numerator of which is the amount of the GST

exemption under § 2631 allocated to the trust and the denominator of which is the value of the property transferred to the trust.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 that may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 2632(c)(1) (redesignated as § 2632(e)(1) by P.L. 107-16, § 561(a)) provides that, in general, any portion of an individual's GST exemption that has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated as follows: (A) first, to property that is the subject of a direct skip occurring at such individual's death; and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations provides that a decedent's unused GST exemption is automatically allocated on the due date for filing the Form 706, or Form 706NA, to the extent not otherwise allocated by the decedent's executor on or before that date. Unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of chapter 11 (chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. No automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust. The automatic allocation is irrevocable.

Section 2652(a)(1) provides that for purposes of chapter 13 the term "transferor" means: (A) in the case of any property subject to the tax imposed by chapter 11, the decedent; and (B) in the case of any property subject to the tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 2652(a)(3) provides, in pertinent part, that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056 by reason of

subsection (b)(7) thereof, the estate of the decedent may elect to treat all of the property in such trust for GST purposes as if the election to be treated as qualified terminable interest property had not been made. This election is referred to as a "reverse" QTIP election, and, as provided in § 26.2652-2(b), is made on the return on which the QTIP election was made. As a result, the decedent's GST tax exemption may be allocated to the QTIP trust.

Section 26.2652-2(a) provides, in part, that a "reverse" QTIP election is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies. Section 26.2652-2(b) provides that a "reverse" QTIP election is made on the return on which the QTIP election is made.

Section 26.2654-1(b)(1)(ii) provides that the severance of a trust that is included in the transferor's gross estate into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; and

- (A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust; and
- (B) The severance occurs prior to the date prescribed for filing the federal estate tax return (including extensions actually granted) for the estate of the transferor; and
- (C) Either (1) the new trusts are severed on a fractional basis or (2) if the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of § 26.2654-1(a)(1)(ii) if it were paid to an individual. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a non-pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding.

Section 26.2654-1(b)(2) provides that if a court order severing the trust has not been issued at the time the federal estate tax return is filed, the executor must indicate on a statement attached to the return that a proceeding has been commenced to sever the trust and describe the manner in which the trust is proposed to be severed. A copy of the petition or other instrument used to commence the proceeding must also be attached to the return. If the governing instrument of a trust or local law authorizes the severance of the trust, a severance pursuant to that authorization is treated as meeting the requirements of § 26.2654-1(b)(1)(ii)(B) if the executor indicates on the federal estate tax return that separate trusts will be created (or funded) and clearly sets forth the manner in which the trust is to be severed and the separate trusts funded.

Under § 301.9100-1(c) of the Procedure and Administration regulations, the Commissioner may grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Code except subtitles E, G, H, and I.

Section 301.9100-2 provides an automatic extension of time for making certain elections.

Section 301.9100-3(a) provides, in pertinent part, that requests for extensions of time for regulatory elections that do not meet the requirements of § 301.9100-2 must be made under the rules of § 301.9100-3. Requests for relief subject to § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1) provides, in part, except as provided in § 301.9100-3(b)(3)(i) through (iii), a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

Section 301.9100-3(c)(1) provides, in pertinent part, that the Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the Government will not be prejudiced by the granting of relief.

In this case, since a QTIP election was made on Decedent's Form 706, the assets of the Marital Trust are currently includible in Spouse's gross estate pursuant to § 2044. In addition, Spouse is considered the transferor of such property for GST tax purposes, thereby initially precluding the allocation of any of Decedent's GST exemption to the Marital Trust. However, if the Marital Trust is severed into a GST Exempt Marital Trust and GST Nonexempt Marital Trust in accordance with § 2642(a)(3) and Decedent's estate is granted an extension of time to make a "reverse" QTIP election under § 2652(a)(3) with respect to the assets of the GST Exempt Marital Trust, Decedent will be treated as the transferor of those assets for GST tax purposes. Further, the automatic allocation rules set forth in § 2632(e) will operate to allocate Decedent's remaining GST exemption to the GST Exempt Marital Trust.

We conclude that the standards of §§ 301.9100-1 and 301.9100-3 have been satisfied. Accordingly, we grant Decedent's estate an extension of time of 60 days from the date of this letter to sever the Marital Trust into the GST Exempt Marital Trust and the GST Nonexempt Marital Trust and to make a "reverse" QTIP election under § 2652(a)(3). Once the "reverse" QTIP election is made, § 2632(e) will operate to allocate Decedent's remaining GST exemption to the GST Exempt Marital Trust. The election should be

made on a supplemental Form 706 filed with the Internal Revenue Service Center, Cincinnati, Ohio 45999. A copy of this letter should be attached to the return.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

William P. O'Shea
Associate Chief Counsel
(Passthroughs & Special Industries)